

Part IV - Items of General Interest

Announcement 2002-43

Purpose

The Internal Revenue Service (the “Service”), Office of Tax Exempt Bonds, announces a program under which certain issuers of state or local bonds may request a closing agreement pursuant to which bonds (the “refinancing bonds”) issued to refinance certain outstanding bonds (the “refinanced bonds”) will be recognized as acquisition bonds (and therefore will not be treated as a refunding issue under § 1.150-1(d) of the Income Tax Regulations) and the allocations of proceeds to expenditures for such bonds will be respected.

Background

The closing agreement program applies to issues of state or local bonds issued in connection with hospital affiliation transactions where two or more existing 501(c)(3) organizations (the “Sellers”) agreed to merge their operations by selling either the assets of the Sellers or control of the Sellers to a new or pre-existing 501(c)(3) organization that the Sellers jointly control. In particular, the program applies where the issuer did not characterize the refinancing bonds as a refunding issue under § 1.150-1(d)(2) and did not treat proceeds of the refinancing bonds as being used for all of the purposes for which the proceeds of the refinanced bonds were used. The Service is providing the program because it recognizes the policy reasons for the hospital affiliation transactions and the uncertainty in applying the allocation rules and has a desire to quickly and fairly resolve the examinations of the refinancing bonds.

On April 10, 2002, proposed regulations were published relating to the definition of refunding under § 1.150-1(d). Issuers may apply the proposed regulations in whole, but not in part, to any issue that is sold on or after the date the proposed regulations were published in the Federal Register and before the effective date of the final regulations.

Closing Agreement Procedure

An issuer seeking relief must execute a closing agreement with the Service on or before December 31, 2002, following the procedures in this announcement. An issue of bonds is eligible for the program whether or not it is under examination. The closing agreement will be prepared by the Service and, in general, will be in substantially the same form as the model closing agreement set forth in IRM 7.6.2. For issues that are not under examination, issuers should submit a request for closing agreement pursuant to Notice 2001-60, 2001-40 I.R.B. 304.

As a condition to executing a closing agreement, the issuer must agree to take one of the following actions:

1. Pay, simultaneously with the execution by the issuer of the closing agreement, the applicable closing agreement amount (as described below). Proceeds of tax-exempt bonds may not be used to pay the closing agreement amount.
2. Treat the proceeds of the refinancing bonds as used for the purposes for which the proceeds of the refinanced issue were used and restructure the refinancing bonds in a manner such that the bonds comply with the applicable requirements of §§ 103 and 141 through 150 of the Internal Revenue Code that are impacted by such allocation.

Closing Agreement Amount

The closing agreement amount is equal to 30 percent of the present value of the arbitrage profit on the escrow investments that were purchased with the proceeds of the refinancing bonds to be used to repay the refinanced bonds, plus interest accruing at the underpayment rate under § 6621, beginning on the date that is 60 days from [RELEASE DATE]. Arbitrage profit is the excess of the amount earned on the escrow investments over the amount that would have been earned if the investments bore a yield equal to the yield on the refinancing bonds. Present value is computed as of the issue date of the refinancing bonds, using the yield on the refinancing bonds as the discount rate.

Yield on an issue will be equal to the yield on the issue under § 148. If all or a portion of the refinancing bonds bear interest at a variable rate, the variable rate will be equal to the actual values of the variable rate of the refinancing bonds from the issue date until the date of any closing agreement, and the reasonably expected values of the variable rate for the remaining term of the refinancing bonds. Expectations regarding values will be treated as reasonable if the values are equal to the value of an objective index of tax-exempt variable rates (similar to the variable rate on the refinancing bonds) on the date of the closing agreement.

Restructuring Option

Any restructuring must be completed within 180 days of the execution of the closing agreement. To the extent that a restructuring involves the redemption of bonds, the issuer must provide a written notice to the bondholders similar to the notice described in § 5.02(5) of Rev. Proc. 97-15, 1997-1 C.B. 635.

Allocations of proceeds to bonds for non-qualified purposes of § 145(a)(2) will be treated as reasonable if made consistently with the rule set forth in § 1.141-12(j)(2).

Submissions

Submissions with regard to the closing agreement program should be directed to:

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Drafting Information

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